



OFFICE OF THE
CITY AUDITOR

**A COMPLIANCE AUDIT OF THE CITY
AND REDEVELOPMENT AGENCY INVESTMENT
PROGRAMS FOR MARCH AND APRIL 1986**

A REPORT TO THE
SAN JOSE
CITY COUNCIL
JUNE 1986

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EXECUTIVE SUMMARY

In response to an August 5, 1985 Council Finance Committee request, the City Auditor has initiated a process for monthly reviews of investments for the City and the Redevelopment Agency. These reviews have resulted in recommendations to improve the investment program. Finance is taking steps to implement the City Auditor's recommendations to correct the problems noted during the monthly reviews.

Our review of investment transactions for the City and the Redevelopment Agency for March and April 1986 indicates that Finance has generally complied with Investment Policy requirements. We did note, however, three instances of technical noncompliance in the areas of dealer prequalification and issuer rating. Noncompliance continues in areas which require more in-depth staff work and legal assistance. These areas include evaluating dealer financial condition, executing formal dealer and safekeeping agreements and expediting delivery of transaction confirmations. Improvements in documentation and control procedures are occurring and will be monitored after implementation until Finance staff becomes familiar with the procedures. Appendix A contains an overview of this review.

The City Auditor has developed a number of recommendations to enhance compliance with the City's Investment Policy and improve the City's investment program. Our review indicates that Finance is taking steps to comply with prior audit recommendations. Of the twenty-five recommendations contained in the Reviews of September, October, November/December 1985, and January/February 1986 Investments:

- o Thirteen have been fully implemented,
- o Two are combined with other recommendations,
- o Four are implemented, but procedures need improvement, and
- o Six are in progress

Refer to Appendix B for an overview of Implementation Status.

It is recommended that:

Recommendation #1:

Finance obtain Private Sector Panel approval of alternative dealer financial information requirements and amend the Investment Policy accordingly. (Priority 2)

Recommendation #2:

Finance include in the Investment Procedures specific instructions regarding all Policy provisions. These instructions should address 1) all required dealer financial information requirements 2) dealer acknowledgement of the City's Investment Policy 3) pre-formatted wire instructions for banks and 4) instrument and issuer ratings. (Priority 2)

Recommendation #3:

Finance report all technical exceptions to the City's Investment Policy to the Finance Committee in its Monthly Investment Report. (Priority 2)

THE MARCH AND APRIL 1986 REVIEW:
-GENERAL COMPLIANCE OCCURRING
-THREE TECHNICAL NONCOMPLIANCES NOTED
-ADDITIONAL WRITTEN GUIDELINES NEEDED

Our review of investment transactions for the City and the Redevelopment Agency for March and April 1986 indicates that Finance has generally complied with Investment Policy requirements. We did note, however, three instances of technical noncompliance in the areas of dealer prequalification and issuer rating. Noncompliance continues in areas which require more in-depth staff work and legal assistance. These areas include evaluating dealer financial condition, executing formal dealer and safekeeping agreements and expediting delivery of transaction confirmations. Improvements in documentation and control procedures are occurring and will be monitored after implementation until Finance staff becomes familiar with the procedures. Appendix A contains an overview of the results of this review.

Dealer Prequalification

The City's Investment Policy states in part:

Requirement for Financial Statements

"Each bank, savings and loan and security dealer, otherwise qualified under the provisions of this policy, who wishes to do business with the City shall submit a copy of its latest financial statement to the City including a balance sheet and profit and loss statement..." (Emphasis added)

Notice to Dealers

"The City shall annually send a copy of the current edition of this Investment Policy to all institutions which are approved to handle City of San Jose investments.

Receipt of the Policy, including confirmation that it has been reviewed by persons handling the City's account, shall be acknowledged in writing within thirty days." (Emphasis added).

Pre-formatted Wire Transfers

"Wherever possible, the City will use pre-formatted wire transfers to restrict the transfer of funds to pre-authorized accounts only..." (Emphasis added).

Audit staff noted two instances of noncompliance with the above Investment Policy provisions.

In the first instance, a dealer refused to transmit a Profit and Loss (P&L) Statement on the basis that the firm is a Private Partnership and that such information is not for public consumption. Staff did not question the refusal, thus the dealer's financial information file was incomplete. According to the Director of Finance, it would be detrimental to the City's investment program to discontinue doing business with this dealer solely because of its refusal to provide a Profit and Loss Statement. The Director further stated that this dealer 1) reports to the Market Reports Division of the

Federal Reserve and, 2) is one of the only major dealers the City can do business with because of the City's current lawsuit stemming from the bond loss. Finance is attempting to define and secure an acceptable substitute for the required Profit and Loss Statement. In our opinion, Finance should 1) obtain concurrence from the Private Investment Panel for any alternatives to the current Policy requirements, and 2) initiate amendments to the Policy as necessary. In the meantime, Finance should report continued noncompliances as a technical exception to the Policy in its Monthly Investment Report.

In the second instance, staff purchased commercial paper directly from the issuer and did not first insure that: 1) the issuer/dealer had received and acknowledged a copy of the Investment Policy and 2) the bank had received preformatted wire instructions for the issuer/dealer.

The Treasurer has subsequently instructed staff in proper procedures to prevent similar oversights in the future. We recommend that these instructions be incorporated into Treasury's written guidelines.

Overall improvements have occurred regarding dealer prequalification. Of the eleven dealers involved in investment transactions during March and April 1986 all either report to

the Market Report Division of the Federal Reserve or meet the Policy's rating requirements. With the exception of the one instance noted above all of the dealers have acknowledged the City's investment policy. Treasury is still in the process of obtaining updated financial statements from all dealers. Treasury evaluation of dealer financial condition will occur once evaluation procedures are finalized. The City Attorney's Office is reviewing a draft services agreement, which includes master repurchase provisions. Finance has targeted June 1 for execution of agreements with dealers.

Purchases

Of the transactions reviewed, all purchases except one met Policy rating, type and location requirements for issuer and instruments.

The City's Investment Policy states in part:

"The California Government Code restricts cities to investing in commercial paper of the highest rankings provided for by Moody's Investment Service or Standard and Poor's. Issuing corporations must be organized and operating within the United States and have total assets in excess of \$500,000,000..." (Emphasis added).

The one instance of noncompliance with the above Policy requirement was for the purchase of a commercial paper of a company that was a subsidiary of a large parent company. Finance could not assure compliance with the \$500,000,000 requirement because only the parent company's total assets were published in Finance's reference source (Moody's). The dealer has advised Treasury that a specific agreement between the parent and subsidiary satisfies the legal requirements. The dealer is transmitting a copy of this information. We recommend that Finance request the City Attorney to review the agreement for compliance with legal requirements when it is received.

The Treasurer has subsequently instructed staff not to solely utilize rating or financial information for a parent company when evaluating a subsidiary company. We are recommending that these instructions also be incorporated into Treasury's investment guidelines.

Overall Finance complied with Investment Policy purchasing requirements during March and April 1986. Repurchase agreements met Policy collateral requirements as well as Treasury's more recent internal guidelines requiring that collateral be set at 102% of the agreement's face value for agreements exceeding one day. Procedures to document market

condition and purchase strategy were implemented in December. This documentation requires further review as Treasury staff becomes more familiar with the process.

Portfolio Mix

Our review indicated that Finance complied with Policy requirements for portfolio diversification.

Safekeeping

Formal safekeeping agreements, currently in draft form, are targeted for execution with the safekeeping agents by June 1.

In earlier reviews, we found that safekeeping receipts were not being reconciled with Treasury confirmation documents. Based on this review, the Accounting Division is now reconciling safekeeping receipts to Accounting's copy of Treasury's confirmation document. Also, Accounting is following up on safekeeping release forms not received on time.

Other Procedures/Controls

Treasury has implemented some improvements in the documentation of cash flow information. However, the accuracy of the cash flow forecast and the usefulness of documentation to third party review is still limited. The overview investment procedures are updated and MONEymax instructions are completed. Detailed procedures, or desk manuals, will be completed as time permits.

In an earlier review, we recommended that Finance separate the functions of receiving investment income from placing investments. As an alternative to reorganization, the Treasurer, rather than the Treasury Assistant, signs revenue vouchers for investment income. This procedure requires further evaluation.

CONCLUSION

Our review of March and April 1986 investment transactions revealed three single instances of technical noncompliance. Finance was informed of these noncompliances and appears to be taking steps to prevent future occurrences. Finance continues to make progress on implementing prior audit recommendations with July 1, 1986 targeted as the date for complete implementation.

RECOMMENDATIONS

It is recommended that:

Recommendation #1:

Finance obtain Private Sector Panel approval of alternative dealer financial information requirements and amend the Investment Policy accordingly. (Priority 2)

Recommendation #2:

Finance include in the Investment Procedures specific instructions regarding all Policy provisions. These instructions should address 1) all required dealer financial information requirements 2) dealer acknowledgement of the City's Investment Policy 3) pre-formatted wire instructions for banks and 4) instrument and issuer ratings. (Priority 2)

Recommendation #3:

Finance report all technical exceptions to the City's Investment Policy to the Finance Committee in its Monthly Investment Report. (Priority 2)

FOLLOW-UP ON PRIOR
RECOMMENDATIONS

The City Auditor has developed a number of recommendations to enhance compliance with the City's Investment Policy and improve the City's investment program. Our review indicates that Finance is taking steps to comply with prior audit recommendations. Of the twenty-five recommendations contained in the Reviews of September, October, November/December 1985 and January/February 1986 Investments:

- o Thirteen have been fully implemented,
- o Two are combined with other recommendations,
- o Four are implemented, but procedures need improvement,
and
- o Six are in progress.

Following is an implementation status report for prior recommendations. An overview chart showing the implementation status of prior recommendations is contained in Appendix B.

September 1985 Investment Review

Recommendation #1:

Treasury staff utilize MONEymax in managing the portfolio and making investment decisions by: running a portfolio profile daily or on each day when purchases, sales or maturities occur; and using the portfolio report in making investment decisions. (Priority 1)

Status:

Implemented.

Recommendation #2:

Treasury staff insure that entry MONEymax is timely and accurate by: entering the transaction data on the date that the transaction occurs; running machine numbered, logged and dated batch reports for all entries; and reviewing batch reports for accuracy. (Priority 1)

Status:

Implemented.

Recommendation #3:

Finance enhance staff's ability to utilize MONEYMAX by: providing comprehensive training for employees in the use of MONEYMAX; and preparing a simplified instructions manual on the use of MONEYMAX for Finance employees. (Priority 2)

Status:

Treasury hired an Account Clerk II who is primarily responsible for MONEYMAX input, reports and various graphs and schedules for the monthly investment report. This employee took the basic MONEYMAX training and also joined the other Treasury staff members who attended the formal training for the MONEYMAX Gateway Module held on April 28-30. Training will be on-going.

The MONEYMAX instruction manual was completed on March 26, 1986.

Implemented.

Recommendation #4:

Treasury staff advise Finance management of portfolio status on a timely basis by distributing a copy of the portfolio profile report in Recommendation #1 to the Treasurer, Chief of Accounting and the Finance Director. (Priority 1).

Status:

Implemented.

Recommendation #5:

Treasury staff prepare revenue vouchers for maturities, sales and interest payments on the date funds are deposited or payment is received. (Priority 1).

Status:

Implemented.

Recommendation #6:

Treasury staff maintain documentation to verify information used each day in making investment decisions, including the portfolio profile report and all cash flow information. (Priority 2)

Status:

Treasury has improved procedures. MONEymax Cash Flow Forecasts are retained in a chronological binder. Daily Cash Flow sheets now include the run date of the MONEymax Cash Flow Forecast and the date and source of interim information used to determine investible funds. Further improvements are dependent upon planned revisions to the accounting system, fine tuning revenue forecasting methods and departmental planning.

Implemented.

Recommendation #7:

Finance complete procedures regarding prequalification of financial institutions. (Priority 1)

Status:

This recommendation is now included in Recommendation #3 of the October Investment Review.

Recommendation #8:

Treasury document reasons for sales.

Status:

On March 14, 1986, Treasury sold Negotiable Certificates of Deposit. Based on documents available, the securities were sold because of non-compliance with Policy quality criteria (rating) and the South Africa Free criteria. Documentation for the sale has improved.

Further follow-up required.

Recommendation #9:

Accounting complete improvements in reconciliation procedures.

Status:

The intent of this recommendation is now included in Recommendations 7 and 12 in the review of October transactions.

October 1985 Investment Review

Recommendation #1:

Finance comply with Policy requirements to execute formal safekeeping agreements with the City and Redevelopment Agency's Custodial Agents to assure that the City's interest in securities is adequately perfected. (Priority 1)

Status:

A draft safekeeping agreement is still undergoing legal review. Because of a change in City's bank, the target date for the execution of the safekeeping agreement has been moved to June 1, 1986.

Further follow-up is required.

Recommendation #2:

Treasury staff comply with Policy requirements to maintain collateral at 100% of the repurchase agreement's face value, marked-to-market daily, or sufficiently in excess of the agreement's face value. (Priority 1)

Status:

Implemented.

Recommendation #3:

Finance comply with Policy requirements to establish procedures to evaluate and monitor dealer financial condition and execute formal master repurchase agreements and services agreements with dealers. (Priority 1)

Status:

Treasury has completed draft procedures for evaluating financial statements. The evaluation process has begun and will continue as time allows. The City Attorney's Office is reviewing a draft dealer service agreement which includes master repurchase provisions. Finance expects to execute the agreements by June 1, 1986.

Further follow-up is required.

Recommendation #4:

Treasury establish guidelines for repurchase agreements which 1) allow substitution of securities only on an exception basis, and 2) limit the number of securities used as collateral. Treasury document reasons for exceptions to the guidelines. (Priority 1)

Status:

The amendments to the City's Investment Policy included provisions for the authorization and confirmations of substitution of collateral. Also, the revised overview procedures establish guidelines for substitution of securities held as collateral in a repurchase agreement. The guidelines require Treasury to document circumstances related to substitution. In addition, the guideline limits the number of securities used as collateral to five.

Implemented.

Recommendation #5:

Finance obtain clarification from the Private Sector Investment Committee regarding the issues of repurchase agreement collateral, issuer percentages, and financial institution qualifications. (Priority 2)

Status:

On March 21, 1986, the Private Sector Panel met and approved various Investment Policy changes proposed by Finance Department. The revised Policy incorporated the approved

changes which, among other issues, addressed the Panel's recommendation that securities accepted as collateral for repurchase agreements be limited to the types of government securities authorized for purchase in the Policy. In addition, the Panel members recommended that a preference for shorter maturities for such collateral be reflected in Finance Department procedures. Finance will address this latter recommendation in the Treasury Investment Procedures.

The revised Policy has incorporated the concept of portfolio percentage limits, including the 10% of portfolio funds to be invested at any one time in repurchase agreements with a single dealer.

Implemented.

Recommendation #6:

Finance include in its Monthly Investment Report all investments which do not comply with Policy provisions. Finance should indicate which investments are subject to on-going review for potential sale. (Priority 2)

Status:

Implemented.

Recommendation #7:

Accounting ensure that safekeeping receipts are promptly received and reconciled. (Priority 1)

Status:

Implemented.

Recommendation #8:

Treasury establish data entry standards to ensure the accuracy of MONEymax entry, including adequate issuer identification. (Priority 1)

Status:

Treasury has completed an instruction manual for the investment MONEymax system. The new Account Clerk II assigned to the MONEymax operation will update the manual as needed.

Further follow-up is needed.

Recommendation #9:

Treasury enter the dealer's name and securities held as collateral for repurchase agreements into the MONEymax system.
(Priority 1)

Status:

Entry is now taking place. No further follow-up is required. Treasury staff has become familiar with the procedure.

Implemented.

Recommendation #10:

Treasury document daily investment strategy and purchase decisions. (Priority 2)

Status:

Treasury is becoming more familiar with the new procedures.

Further follow-up is required.

Recommendation #11:

Treasury segregate the functions of investing funds and receiving investment income. (Priority 1)

Status:

Treasury has implemented an alternative procedure. The Chief of Treasury or a designee not directly involved in placing investments approve investment-related revenue vouchers.

Further follow-up is required.

Recommendation #12:

Finance establish additional procedures to ensure that controls are functioning and written verification of purchases and sales is complete and timely. Specifically, procedures need to be established to 1) monitor compliance with Policy provisions regarding release of funds or securities 2) provide for 24 hour preparation and mailing of confirmations 3) implement pre-numbered and controlled confirmation documents and 4) date stamp and reconcile dealer, safekeeping, debit and credit advices as received. (Priority 2)

Status:

The Control Log for wire transfer of funds has been properly initialed since November 1985. The revised Investment Policy now allows five working days for transmittal of confirmations. Implementation of pre-numbered confirmation documents is targeted for July 1, 1986 in order that automation of forms through MONEymax can be explored. Accounting is now date stamping all receipts and advices.

Implemented.

November-December 1985 Investment Review

Recommendation #1:

Finance obtain a legal opinion to determine requirements for an independent third party custodian for securities involved in City investments. (Priority 2)

Status:

Finance has ceased executing repurchase agreements with the banks which serve as the safekeeping agents for the City

and the Redevelopment Agency portfolios. The issue of third party custodians may be addressed in the legal review of the proposed safekeeping agreements. Execution of safekeeping agreements is anticipated by June 1, 1986.

Further follow-up is required.

Recommendation #2:

Finance incorporate a clause in the proposed City-initiated dealer agreements to supersede any prior service or master repurchase agreements with the dealer. (Priority 2)

Status:

Finance will include the recommended clause in the master repurchase agreement now under review by legal counsel. Treasury plans to mail the agreements to dealers by June 1, 1986.

Further follow-up is required.

Recommendation #3:

Finance document its Policy interpretations. (Priority 2)

Status:

Finance will have the Policy interpretations documented by May 31, 1986.

Further follow-up is required.

Recommendation #4:

According to Treasury, the City Attorney has advised Finance that 1) there are no Federal laws applicable to the investment program and 2) The Treasurer's Handbook, which Treasury obtained, contains accurate, up-to-date information on State laws.

Implemented.

CITY OF SAN JOSE - MEMORANDUM

TO: Honorable Mayor and City Council
SUBJECT: RESPONSE TO MARCH/APRIL 1986
COMPLIANCE REVIEW OF CITY
INVESTMENT TRANSACTIONS

FROM: Edward G. Schilling
Director of Finance
DATE: June 10, 1986

APPROVED

DATE

The Finance Department concurs with the findings and recommendations of the March/April Investment Program Compliance Review. Specific responses to the three recommendations follow:

Recommendation #1

Finance concurs with the recommendation to consider alternative dealer financial information requirements and will present them for Private Sector Panel feedback at its next meeting. Following that discussion, the Investment Policy should be amended.

Several alternatives have been explored to deal with the problem of evaluating firms such as the one which would not provide its profit and loss statement. Since it is a private partnership, the only information normally available for public consumption is an annual review which includes a balance sheet only. However, the partnership is registered with the Securities and Exchange Commission (SEC). All SEC-registered dealers must conform to Rule 15c 3-1. This rule states that a dealer's liquid capital, reduced by its measured risk, must exceed the dealer's obligations to its customers on a continuous basis. Finance will propose to the Private Sector Panel that an SEC-registered private partnership be screened on two factors as follows: 1) disclosure of its excess net capital in the notes to the statement of financial condition, and 2) a separate letter from its CPA firm attesting to the facts that Rule 15c 3-1 has been complied with and the dealer's internal systems and controls have no material inadequacies.

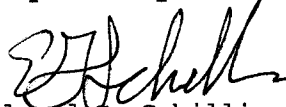
Recommendation #2

Finance concurs with the recommendation to record in its procedures specific instructions pertaining to dealer and issuer prequalifications. Special situations, such as the one governed by the parent's support agreement, may be appropriate to consider for the City's portfolios but should be documented in advance of the execution of the transactions. The Treasurer has issued instructions to staff. These will be incorporated into the Investment Procedures.

Recommendation #3

Finance concurs with the recommendation to report all technical exceptions to City's Investment Policy to the Finance Committee in its Monthly Investment Report. A paragraph describing those exceptions will be included in Exhibit D of the Executive Summary.

Respectfully submitted,


Edward G. Schilling
Director of Finance

RECEIVED

JUN 10 1986

CITY AUDITOR

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APPENDIX A

SUMMARY OF COMPLIANCE QUESTIONS FOR REVIEW OF MARCH 1986 AND APRIL 1986 INVESTMENT TRANSACTIONS OF THE CITY AND THE REDEVELOPMENT AGENCY

<u>Compliance Question</u>	Based on Sample Review of Finance Documentation Did all Transactions Meet Criteria?	
	<u>March 1986</u>	<u>April 1986</u>
A. PREQUALIFICATION OF DEALERS		
1. Is the Dealer (1) on the list of Government Security Dealers Reporting to the Market Reports Division of Federal Reserve, or does the dealer meet the required Keefe, Bruyette and Woods rating?	YES	YES
2. Has the Dealer or Bank filed an acknowledgement of receipt and review of the City's Investment Policy with Treasury?	NO	NO
3. Have Financial Statements been filed with Treasury?	YES	YES
4. Do the Financial Statements include a Balance Sheet and a Profit and Loss Statement?	NO	NO
5. Are the Financial Statements current?	NO	NO
6. Has Treasury reviewed the Financial Statements?	NO	NO
7. Has a Services Agreement been executed?	NO	NO

(1) Includes banks and savings and loans acting as dealers. Treasury accepts a Keefe, Bruyette and Woods rating of "B", or "C" for selected major California banks, in lieu of primary dealer status for banks and savings and loans.

APPENDIX A

SUMMARY OF COMPLIANCE QUESTIONS FOR REVIEW OF MARCH 1986 AND APRIL 1986 INVESTMENT TRANSACTIONS OF THE CITY AND THE REDEVELOPMENT AGENCY

<u>Compliance Question</u>	Based on Sample Review of Finance Documentation Did all Transactions Meet Criteria?	
	<u>March 1986</u>	<u>April 1986</u>
B. PROVISIONS APPLYING TO ALL PURCHASES		
1. Purchase is of an approved instrument?	YES	YES
2. Purchase Maturity is within policy limits for instrument?	YES	YES
3. Wire Transfer of funds initiated by employee other than employee initiating investment?	YES	YES
4. Wire Transfer of funds carried out according to the terms of preformatted Wire Transfer letter?	NO	NO
C. PORTFOLIO MIX		
1. Is within Policy limits for category of instruments?	YES	YES
2. Total with a single issuer, other than government issues:		
a) Is within 10% of total portfolio, unless an overnight repo?	YES	YES
b) For uninsured-uncollateralized issues, is within 5% of total portfolio?	YES	YES
D. TIME DEPOSITS - BANKS AND SAVINGS AND LOANS		
1. Bank or savings and loan is located in San Jose area (Santa Clara County)?	NONE	YES

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SUMMARY OF COMPLIANCE QUESTIONS FOR REVIEW OF MARCH 1986 AND APRIL 1986 INVESTMENT TRANSACTIONS OF THE CITY AND THE REDEVELOPMENT AGENCY

<u>Compliance Question</u>	Based on Sample Review of Finance Documentation Did all Transactions Meet Criteria?	
	<u>March 1986</u>	<u>April 1986</u>
2. If not San Jose area, is it a minority bank?	NONE	NONE
3. Is a Contract for Public Funds Deposit on file?	NONE	YES
4. Is a Waiver for Collateralization on file (for insured portion)?	NONE	NO
5. For uninsured portion (over \$100,000), is the deposit with a bank or savings and loan with a Keefe, Bruyette and Woods rating of "B" or better, unless a "selected California bank" (Bank of America or Wells Fargo) rated "C" or better?	NONE	NONE
E. U. S. GOVERNMENT AGENCY ISSUES		
1. Is issue by one of the following: o Federal Farm Credit Bank; o Federal Home Loan Bank (including FHLMC) or o Federal National Mortgage Association?	YES	YES
F. REPURCHASE AGREEMENTS		
1. Collateral is U.S. Treasury or Government Agency issue approved for purchase by Policy?	YES	YES
2. If overnight, collateral is equal to 100% of the repurchase agreement's face value?	YES	YES

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SUMMARY OF COMPLIANCE QUESTIONS FOR REVIEW OF MARCH 1986 AND APRIL 1986 INVESTMENT TRANSACTIONS OF THE CITY AND THE REDEVELOPMENT AGENCY

<u>Compliance Question</u>	Based on Sample Review of Finance Documentation Did all Transactions Meet Criteria?	
	<u>March 1986</u>	<u>April 1986</u>
3. If other than overnight, collateral is marked-to-market on a daily basis and maintained equal to 100% of the repurchase agreement's face value; or is sufficiently in excess of the repurchase agreements face value?	NONE	NONE
G. REVERSE REPURCHASE	NONE	NONE
H. BANKER'S ACCEPTANCES		
1. Is the issuer a bank or savings loan with a Keefe, Bruyette and Woods rating of "B" or better, unless a "selected major California bank" (Bank of America or Wells Fargo) rated "C" or better?	YES	YES
I. NEGOTIABLE CERTIFICATES OF DEPOSIT		
1. Is the issuer a bank or savings and loan with a Keefe, Bruyette and Woods rating of "A/B" or better?	NONE	NONE
J. COMMERCIAL PAPER		
1. Is this a domestic corporation?	YES	YES
2. Does this institution have the highest rating by Moody's or Standard and Poor's?	YES	YES
3. Does this institution have total assets of \$500,000,000 or more?	YES	YES
4. Does this institution have an "A" rating or higher on its own indebtedness other than its commercial paper?	YES	YES

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SUMMARY OF COMPLIANCE QUESTIONS FOR REVIEW OF MARCH 1986 AND APRIL 1986 INVESTMENT TRANSACTIONS OF THE CITY AND THE REDEVELOPMENT AGENCY

<u>Compliance Question</u>	Based on Sample Review of Finance Documentation Did all Transactions <u>Meet Criteria?</u>	
	<u>March 1986</u>	<u>April 1986</u>
K. SAFEKEEPING-TREASURY PROCEDURES		
1. Person initiating release of securities is not same person initiating sale?	YES	NONE
2. Written confirmation for release of City-owned securities was transmitted to Safekeeper within 5 working days of telephone instructions.	NO*	NONE
L. SAFEKEEPING - SECURITY/COLLATERAL HELD		
1. Collateral held by a Safekeeping Agent under the terms of a Safekeeping Agreement with the City?	NO	NO
2. For securities serving as collateral for a repurchase agreement which are not held by a Safekeeping Agent, are the securities held by a third party custodian with a Safekeeping Agreement with the City?	NONE	NONE
3. For uninsured/collateralized Time Deposits in a savings and loan, is collateral held by the Federal Home Loan Bank?	NONE	NONE

*Response was based on original policy requirement (within 24 hours).

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SUMMARY OF COMPLIANCE QUESTIONS FOR REVIEW OF MARCH 1986 AND APRIL 1986 INVESTMENT TRANSACTIONS OF THE CITY AND THE REDEVELOPMENT AGENCY

<u>Compliance Question</u>	Based on Sample Review of Finance Documentation Did all Transactions Meet Criteria?	
	March	April
	<u>1986</u>	<u>1986</u>
4. For uninsured/collateralized Time Deposits in a bank, is collateral held in the City's name in:	NONE	NONE
a) The issuing banks' trust department, provided the bank has a Safekeeping Agreement with the City, or	NONE	NONE
b) In the San Francisco Federal Reserve Bank?		
M. REPORTING		
1. Exceptions reported to Finance Committee?	YES	YES
<u>OTHER AREAS</u>		
1. Was sale necessary to meet cash needs?	NO	NONE

APPENDIX B

SUMMARY OF IMPLEMENTATION STATUS
FOR PRIOR RECOMMENDATIONS

<u>Recommendation</u>	<u>Status</u>
<u>REVIEW OF SEPTEMBER 1985 INVESTMENTS</u>	
<u>Recommendation #1</u> Treasury staff utilize MONEymax in managing the portfolio and making investment decisions by: running a portfolio profile daily or on each day when purchases, sales or maturities occur; and using the portfolio profile report in making investment decisions. (Priority 1)	Implemented
<u>Recommendation #2</u> Treasury staff insure that entry into MONEymax is timely and accurate by: entering transaction data on the date that the transaction occurs; running machine numbered, logged and dated batch reports for all entries; and reviewing batch reports for accuracy. (Priority 1)	Implemented
<u>Recommendation #3</u> Finance enhance staff's ability to utilize MONEymax by: providing comprehensive training for employees in the use of MONEymax; and preparing a simplified instruction manual on the use of MONEymax for Finance employees. (Priority 2)	New Account Clerk took MONEymax training. Also, Treasury staff, including the new employee attended Gateway training on April 28-30. MONEymax instruction manual has been completed. Training will be on going. Implemented.

APPENDIX B

SUMMARY OF IMPLEMENTATION STATUS
FOR PRIOR RECOMMENDATIONS

<u>Recommendation</u>	<u>Status</u>
<u>Recommendation #4</u> Treasury staff advise Finance management of portfolio status on a timely basis by distributing a copy of the portfolio profile report in Recommendation #1 to the Treasurer, Chief of Accounting and the Finance Director. (Priority 1)	Implemented.
<u>Recommendation #5</u> Treasury staff prepare revenue vouchers for maturities, sales and interest payments on the date funds are deposited or payment is received. (Priority 1)	Implemented.
<u>Recommendation #6</u> Treasury staff maintain documentation to verify information used each day in making investment decisions, including the portfolio profile report and all cash flow information. (Priority 2)	Implemented.
<u>Recommendation #7</u> Finance complete procedures regarding prequalification of financial institutions.	Included in Recommendation #3 of the October Investment Review.
<u>Recommendation #8</u> Treasury document reasons for sales.	Further follow-up required.

APPENDIX B

SUMMARY OF IMPLEMENTATION STATUS
FOR PRIOR RECOMMENDATIONS

<u>Recommendation</u>	<u>Status</u>
<u>Recommendation #9</u>	
Accounting complete improvements in reconciliation procedures.	This recommendation is now included in Recommendation #7 and 12 of the the October Investment Review.
<u>REVIEW OF OCTOBER 1985 INVESTMENTS</u>	
<u>Recommendation #1</u>	
Finance comply with Policy requirements to execute formal safekeeping agreements with the City and Redevelopment Agency's Custodial Agents to assure that the City's interest in securities is adequately perfected. (Priority 1)	Draft agreement still undergoing legal review. City's Bank will be changed effective June 1, 1986. Execution of safekeeping agreements is anticipated by June 1. Further follow-up required.
<u>Recommendation #2</u>	
Treasury staff comply with Policy requirements to maintain collateral at 100% of the repurchase agreement's face value, marked-to-market value daily, or sufficiently in excess of the agreement's face value. (Priority 1)	Implemented.

APPENDIX B

SUMMARY OF IMPLEMENTATION STATUS
FOR PRIOR RECOMMENDATIONS

<u>Recommendation</u>	<u>Status</u>
<p><u>Recommendation #3</u></p> <p>Finance comply with Policy requirements to establish procedures to evaluate and monitor dealer financial condition and execute formal master repurchase agreements and services agreements with dealers. (Priority 1)</p>	<p>Evaluation procedures are in draft form. Evaluations started and will continue as time allows. City Attorney's Office is reviewing a draft dealer service agreement which includes master repurchase provisions. Finance has targeted June 1, 1986 for execution of agreements. Further follow-up required.</p>
<p><u>Recommendation #4</u></p> <p>Treasury establish guidelines for repurchase agreements which 1) allow substitution of securities only on an exception basis, and 2) limit the number of securities used as collateral. Treasury document reasons for exceptions to the guidelines. (Priority 1)</p>	<p>Implemented.</p>
<p><u>Recommendation #5</u></p> <p>Finance obtain clarification from the Private Sector Investment Committee regarding the issues of repurchase agreement collateral, issuer percentages, and financial institution qualifications. (Priority 2)</p>	<p>Implemented.</p>

APPENDIX B

SUMMARY OF IMPLEMENTATION STATUS
FOR PRIOR RECOMMENDATIONS

<u>Recommendation</u>	<u>Status</u>
<u>Recommendation #6</u> Finance include in its Monthly Investment Report all investments which do not comply with Policy provisions. Finance should indicate which investments are subject to on-going review for potential sale. (Priority 2)	Implemented.
<u>Recommendation #7</u> Accounting ensure that safe-keeping receipts are promptly received and reconciled. (Priority 1)	Implemented.
<u>Recommendation #8</u> Treasury establish data entry standards to ensure the accuracy of MONEYMAX entry, including adequate issuer identification. (Priority 1)	Implemented.
<u>Recommendation #9</u> Treasury enter the dealer's name and securities held as collateral for repurchase agreements into the MONEYMAX system. (Priority 1)	Implemented.

APPENDIX B

SUMMARY OF IMPLEMENTATION STATUS
FOR PRIOR RECOMMENDATIONS

<u>Recommendation</u>	<u>Status</u>
<p><u>Recommendation #10</u></p> <p>Treasury document daily investment strategy and purchase decisions. (Priority 2)</p>	<p>Implemented. Requires further monitoring.</p>
<p><u>Recommendation #11</u></p> <p>Treasury segregate the functions of investing funds and receiving investment income. (Priority 1)</p>	<p>Alternative procedures implemented. The Chief of the Treasury or designee not involved in investment activities approves revenue vouchers. Further follow-up required.</p>
<p><u>Recommendation #12</u></p> <p>Finance establish additional procedures to ensure that controls are functioning and written verification of purchases and sales is complete and timely. Specifically, procedures need to be established to 1) monitor compliance with Policy provisions regarding release of funds or securities 2) provide for 24 hour preparation and mailing of confirmations 3) implement pre-numbered and controlled confirmation documents and 4) date stamp and reconcile dealer, safekeeping, debit and credit advices as received. (Priority 2)</p>	<p>Partially implemented. The Control Log for wire transfer of funds has been properly initialed since November 1985. The revised Investment Policy now allows five working days for transmittal of confirmations. Implementation of pre-numbered confirmations is targeted for July 1, 1986. Accounting is now date stamping all receipts and advices.</p>

APPENDIX B

SUMMARY OF IMPLEMENTATION STATUS
FOR PRIOR RECOMMENDATIONS

REVIEW OF NOVEMBER-DECEMBER 1985 INVESTMENTS

<u>Recommendation</u>	<u>Status</u>
<p><u>Recommendation #1:</u></p> <p>Finance obtain a legal opinion to determine requirements for an independent third party custodian for securities involved in City investments. (Priority 2)</p>	<p>Finance has stopped executing repurchase agreements with the bank which safekeeps that portfolio's securities. The issue a of third party custodian will be addressed the proposed safekeeping agreement.</p>
<p><u>Recommendation #2:</u></p> <p>Finance incorporate a clause in the proposed City-initiated dealer agreements to supersede any prior service or master repurchase agreements with the dealer. (Priority 2)</p>	<p>Finance will include the recommended clause in the master repurchase agreement now under review by legal counsel.</p>
<p><u>Recommendation #3:</u></p> <p>Finance document its Policy interpretations. (Priority 2)</p>	<p>Finance plans to complete documentation by June 15.</p>
<p><u>Recommendation #4:</u></p> <p>Finance prepare a compilation and analysis of State and Federal laws applicable to the investment program. (Priority 2)</p>	<p>Implemented.</p>